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C O N F I D E N T I A L SECTION 01 OF 02 LAGOS 002078

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TAGS: EPET ELAB ECON NI
SUBJECT: CHEVRON'S VIEW ON THE DYNAMICS BEHIND THE FUEL PRICE SHOWDOWN

Classified By: ECON:FHDAY for reasons 1.5 (b) and (d)

¶1. (SBU) Summary: According to Chevron management some two weeks ago President Obasanjo ordered the Nigerian National Petroleum Corporation (NNPC) to cancel all outstanding orders for refined petroleum products, thus committing the country to an abrupt course of petroleum market reform and liberalization. Union and NGO reaction was to call for a general strike. Oil companies met among themselves October 6 and will meet with their unions and the NNPC October 7 to plot a course and to decide whether jointly to order a tanker load of refined product to put fuel in the Nigerian pipeline. The downstream traders must assess the likelihood of being allowed to sell the fuel here at a market price. They have assurances from the GON that they can, but the issue is highly political, and they will be prepared to divert the tanker until the last moment. The outcome of the decision is not yet known. Chevron believes the petroleum unions may have lost control of their own policy in the current crisis, and are being swept along towards a strike that is not in their best interests. End Summary

What's broken, and why

¶2. (C) CG Lagos and Consulate officers met with senior management at Chevron/Texaco October 6 for an extensive discussion of upstream and downstream petroleum issues (upstream, septel). Under the current system, we were told, the NNPC imports all refined product and apportions it in a strikingly non-transparent manner among the 1000 or so independent distributors and the 6 major oil companies in the downstream market. The supply is sharply limited by several logistical bottlenecks at Lagos port, so distribution is strictly a zero-sum game -- a situation guaranteed to give rise to the extensive bribery said to plague the NNPC. Many of these independents don't actually sell in Nigeria at all; a sign and a canopy over some pumps are all that is required to get a distribution license from the NNPC. These distributors, license in hand, fill their tankers at the NNPC and deliver the gas across the border. Independents who do sell in Nigeria buy from the NNPC at the subsidized price and sell not at the N34 they are supposed to charge but at the highest price their locality can support.

¶3. (SBU) Having done very nicely on the initial sale the independents improve matters by paying taxes on their volume as if they had sold the petrol for N34; an underpayment that Chevron believes costs the GON $1 billion a year. The status quo is a high performance cash cow for the independent operators and the NNPC bureaucracy, two powerful opponents of reform. The irony, of course, is that these people get rich by operating a defacto free market system, while consumers are gouged by shortages and exhorbitant prices.

¶4. (C) The government is also getting fleeced. The NNPC pays $2 billion a year to buy refined product abroad at market prices and pass it on to distributors at a subsidized price. Added to the $1 billion in under-collected taxes, that is almost seven percent of Nigeria's GDP, but there is more: crude that could have been exported at $29 a barrel is provided to country's refineries at $22 a barrel. In Chevron's view, President Obasanjo is personally persuaded that the system must be fundamentally altered, but does not trust anyone below the top leadership of the NNPC. During the summer he personally "took over the (petroleum) file" and began working with a small alternative body, the Petroleum Products Pricing Regulatory Agency, to help him transform the downstream petroleum economy. 10 to 14 days ago, Chevron says, Obasanjo personally directed the NNPC to cancel all its contracts for supply of refined product (the NNPC had already contracted deliveries for the fourth quarter of '03 and the first quarter of next year). He then informed the oil companies that they would be able to import what they wanted and sell it at market price, with the request that they not exceed N40 per liter in the first month. This draconian step, just before his October 1 announcement of petroleum market liberalization, seems intended to demonstrate that the

bridges back to the old system have been burned; if so, it is a bold gesture.

Fixing it, and cutting the unions' power

¶5. (SBU) At present Nigeria has seven to ten days of refined product on hand. Nothing is in the pipeline. The pricing baton has been handed abruptly to the oil companies, and they are deliberating what to do with it. They met with their unions, amongst themselves, and with the petroleum unions and the NNPC; the outcome is not yet known. They are consulting among themselves to decide whether to pool resources and order a tanker load of fuel as a test case. The ship would lift in South Africa, and during its three to four days enroute the companies will monitor the fluid and intensely political situation here to gauge whether it will be possible to sell the cargo at market rates. If it appears questionable they will divert the ship to a different market in the region.

¶6. (C) Comment: This is real brinksmanship on Obasanjo's part. As the ship nears Lagos the country will be down to a few days reserve. If the unions prevent it from discharging, he will take the country's empty fuel tanks and beat the unions over the head with them. Obasanjo has already handed the unions the opportunity to disrupt the All Africa Games; an object of great national pride. Now the unions must grapple with the awkward dilemma of what to do about the temptation; despite a rather puny call for Nigerians to stay away, so far the unions (and the population) have avoided using the Games to show their displeasure. Chevron thinks Obasanjo's subtext in setting this crisis in motion at this time is to lure the unions into a series of untenable positions with the intent of curbing their power. Obasanjo is not presenting an easy target and is making it harder for the opposition to agree on what the target (the government or the companies) actually is. End Comment

¶7. (C) Chevron thinks (and we agree) there isn't much solidarity between the two petroleum unions (NUPENG and PENGASSAN) and the rest of the opposition. Chevron has been talking to its unions and is sure they understand that deregulation is good for them in the long run. It means a larger, more efficient downstream sector and more gas going into gas tanks at a better price. The unions know (they have told us as much) that the price of a liter of gas isn't the real issue here; it's the overall structure of the sector -- how much is imported, how much is refined here, and where and how it's refined -- that matters. The unions, according to Chevron, have 25,000 well paid members sitting (mostly) idle in Nigeria's four refineries (which, again according to Chevron, really need 6000 workers), and they know well that those refineries cannot compete in price with imports sold at market prices.

Making a deal

¶8. (C) Chevron believes the GON thinks its delapidated refineries at Kaduna and Part Harcourt II are salvageable. Our late-night conversations October 6 with the presidents of the petroleum unions suggest different mixes of salvagable capacity, but the common element is there: a triage assessment, followed by a commitment to make competitive (at a market price in a deregulated sector) some subset of Nigeria's current capacity. This is, however, not what the other unions and NGOs are looking for; they (and the public) are angry about a lot of things and don't care much about the subtleties that matter to the petroleum unions. There will be intense pressure on those unions to reject a separate peace, and they may not be able to resist it; Chevron certainly believes they may be swept away in the current of popular anger over higher fuel prices.
HINSON-JONES